CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

March 24, 2009

TO: The Honorable City Council

FROM: City Manager

SUBJECT: Recommended FY2010 Operating Budget

I am submitting, for City Council's consideration, my Recommended Operating Budget for the fiscal year beginning July 1, 2009. This is the fourth Operating Budget I have presented to you and has been, by far, the most difficult because of the challenging economic conditions facing Virginia and Newport News. For the first time since 1992 (18 years), our City government must contend with an absolute decline in the General Fund revenues from one fiscal year to the next. As you know from my financial briefings since late-summer of 2008, City revenues have dropped significantly during the current fiscal year and are forecast to be $12 million below the FY2009 Budget estimate. This revenue shortfall has required the application of stringent spending and hiring controls for the current fiscal year. Fortunately, these controls, which have been applied to both operating and capital spending, have put the City in the position to finish FY2009 with a positive General Fund balance.

The only significant revenue category where we can expect any growth in FY2010 will come from real estate property taxes. The overall reality for our City government is that for a second year (FY2010), there will be little or no revenue growth, and we face the likelihood that this revenue pattern will continue at least through FY2011. The current economic climate has dictated that our City government makes spending adjustments that are not just short-term deferrals. In considering options for cutting departmental spending in FY2010, I approached this from the perspective that our spending reductions may need to be sustainable over the next two or three years. In this regard, my recommended General Fund Operating Budget of $421,359,000, which is 2.6% below the adopted FY2009 Budget, is a reflection of this diminished fiscal capacity to maintain our current level of services and programs.

Except for the passage of the economic stimulus legislation, which will provide an infusion of federal monies for some targeted City and School programs, there has been little reason to be optimistic that the downward trend in revenues will be reversed soon enough to expect much improvement in the City's overall fiscal situation during FY2010. Although none of the stimulus money has been directly included in the City's budget for FY2010, we have seen some indirect benefits in that the State was able to use federal stimulus money to mitigate some of the cuts it had expected to make in local municipal and school funding for the next fiscal year.

School Funding

At this point, it is still unclear to what extent the federal stimulus monies for Title I and Special Education Programs might be used to enable the School Division to offset the budget reductions caused by the decline in basic State aid. For this reason, my recommendation on the City's contribution to the School Division is to keep the funding essentially equivalent to the FY2009 City contribution. The $113,300,000 recommended for FY2010 is $500,000 less than in FY2009, but this difference only reflects the amount that the Schools would have received from the City and then provided to the Police Department as a reimbursement for the School Resource Officers (SRO) Program. I am recommending that in FY2010 and beyond, that the funding arrangement change so that the total cost for the SRO Program be paid for through the General Fund budget of the Police Department. Given the magnitude of the State aid reductions for local schools resulting from the General Assembly-approved Biennium Budget, I believe that maintaining the local funding for schools at the FY2009 level is reasonable and appropriate, despite the significant decline in revenues available to the City. Once the School Board decides how it will budget for, and use, the nearly $16 million economic stimulus funding allocated to Newport News Public Schools over the next two fiscal years (i.e., 2010 and 2011) for Title I and Special Education, my recommendation on the level of City funding may warrant review.

Employee Compensation and Benefits

My Recommended Operating Budget includes no funding for either across-the-board or merit salary increases for City employees. There is a small amount of funding ($41,600) included to accommodate the federal minimum wage adjustment from $6.55 to $7.25 per hour, that takes effect on July 24, 2009. These adjustments will benefit only part-time and seasonal workers largely employed by our Parks, Recreation and Tourism Department. Sworn Police Officers and Fire staff who have built-in steps at the beginning of their salary scales will still receive their automatic increases. Other than these two exceptions, no funding for any other salary increases has been provided for in the General Fund, Public Utilities Enterprise Fund, or any of the user fee and internal service fund budgets.

On the benefits side, however, I am recommending an additional contribution of $2.5 million to the Pension Trust Fund to bring the City's budgeted contributions to 50% of the Annual Required Contribution or ARC. This modest increase (48% to 50%) in the proportion of the ARC being funded was the most that could be afforded in light of the revenue situation, but it represents a positive step towards the proposed goal of achieving 100% funding of the ARC in eight years. For Other Post-Employment Benefits (OPEB), the City is contributing $8.5 million into the separate OPEB Trust Fund, which is $700,000 more than in FY2009. Because City Council has not yet enacted any changes that would reduce either the claims expenses or accrued liabilities for the OPEB Trust Fund, and since such adjustments are not likely to be effective until sometime after July 1, 2009, it was necessary to budget in FY2010 sufficient monies to cover these expected OPEB claims expenditures. This will ensure that our limited Trust Fund assets would not be further drawn down during FY2010 due to underfunding of claims expenses.

Two other employee benefit programs to be impacted by my Recommended Operating Budget are Tuition Reimbursement and Leave Exchange. The City has had a policy of providing tuition reimbursement for employees working on associate, bachelor and graduate degrees. In the current fiscal year, 154 employees in 27 different departments are participating in this program, which provides reimbursement of tuition costs for up to a maximum of 12 credit hours in a fiscal year (or quarter hour equivalent); this program, will cost $262,700 in FY2009. I am proposing to suspend the program entirely in FY2010, which will save $262,700. This program is beneficial because it has enabled many employees over the years to work full-time with this City, but take college courses part-time to earn degrees that qualify them for higher level positions within the City government. I believe, therefore, that it should be restored, as soon as the City can afford to do so.

Another benefit program that has a very significant budgetary impact is the leave exchange for either retirement credit or contributions into an ICMA 457 retirement savings account. In FY2009, employees were eligible to participate and exchange 1,500 weeks of paid personal leave, at a cost of $1.8 million. I am proposing a temporary modification of the program for FY2010, which would allow the City to avoid most of this expense. My proposal is to allow employees to elect the exchange, but to defer the actual crediting of the two months of service credit and payment into the Pension Trust Fund until the employee actually retires. The ICMA contribution option would continue for FY2010, but I recommend that this option be eliminated in FY2011 and beyond. This deferral mechanism would allow the City to postpone incurring this cost until it is in a position to pay this expense. It also gives the City the option to spread this FY2010 cost over a period of 20 years, as employees actually retire. A more detailed explanation of this modified leave exchange proposal will be provided as a Budget Briefing Paper.

Departmental Spending

My recommended General Fund Operating Budget for FY2010 of $421.4 million includes $244.9 million in appropriations for departmental operations. The need to reduce spending in FY2010 because of a 2.6% decline in expected General Fund revenues has required significant adjustments in virtually every departmental budget. Even after reducing non-personnel accounts to the minimum necessary to meet operational requirements, there was a need to find further savings in the form of the elimination or freezing of positions. My Recommended Operating Budget has a net of 56 fewer General Fund full-time positions. Of the positions eliminated, 17 are presently filled; this will require the application of the City's Reduction-In-Force Policy and could result in some number of layoffs. In addition, 46 positions remain authorized, but are not funded in FY2010. There are also 12 vacant positions being abolished in the Public Utilities Enterprise Fund. In the Budget document, you will find a summary, by department, of these staffing adjustments.

Some of these staffing adjustments will have direct and obvious service delivery implications, such as the proposal to close the West Avenue Library. Several departments have also undertaken significant reorganizations to eliminate positions and reduce spending in the next fiscal year. Because many of the unfunded positions in next year's budget have been vacant for a portion or all of the current fiscal year, departments have already taken action to reassign workloads and to adjust their operations. In essence, departments have already had to "right size" their operations to reflect the fiscal limitations that began in FY2009 and will continue at least through FY2010. What department directors have had to cope with is assessing how the core and priority functions for which they are responsible can be accomplished with a smaller complement of filled positions. In some cases, existing vacancies will have to be filled during FY2010, requiring elimination of other positions that may result in reduction-in-force actions. As we prepared for FY2010, every department was tasked with identifying ways to cut their current service level budgets by up to 10%. However, reductions of that magnitude in most departments would have been very detrimental. Fortunately, cuts of these amounts have not been necessary, given our revenue forecast for FY2010. As in the past three years, Briefing Papers are being prepared to help City Council and citizens understand the implications of the reductions in staffing and corresponding operational and/or service delivery adjustments. These Briefing Papers will be distributed to City Council in advance of your first budget work session on April 7, 2009.

Cash Capital and Debt Service

The combined efforts during the past year, of City Council and staff, to reduce capital spending and postpone the issuance of new general obligation bonds has had a very positive affect on the required appropriations for capital related expenses in FY2010. My Recommended Operating Budget includes $3,875,000 for Cash Capital, which is down significantly from the $4,842,000 funded in the FY2008 Operating Budget, as is the adjusted Cash Capital spending of $3,611,300 in FY2009. Most importantly, these reductions in Cash Capital spending were accomplished without issuing bonds. Reductions were achieved largely by deferring projects, or in the case of the fire apparatus, advance funding the equipment with an appropriation from reserves.

The decision of City Council to substantially reduce the FY2009 Bond Authorization by funding only those projects deemed urgent has allowed the City to hold the line on the required debt service appropriation for FY2010. As confirmed by our Financial Advisor (PFM), advancing the next bond sale from July to April, to take advantage of favorable interest rates, will still allow the City to minimize the financial impact of this bond sale with respect to principal and interest payments due in FY2010. As a result of this strategy, the Recommended Operating Budget will include $35,591,352 for General Fund debt service, or a decrease of $1,629,647 from what is budgeted in the current fiscal year. Much like the proactive approach in imposing a hiring freeze, the steps the City took early in FY2009 to slow down on capital spending has made the task of balancing the FY2010 Operating Budget less difficult.

Community Support Funding

The FY2010 Operating Budget again distinguishes between discretionary grant funding allocated to not-for-profit organizations, from contributions that support regional organizations in which the City of Newport News participates. The Community Support appropriations have been reduced from $2,561,314 in FY2009 to $2,483,492 recommended for FY2010--a cut of $92,822 or 3.0%.

My approach in formulating a Community Support recommendation for the next fiscal year is to provide level funding for organizations that provide necessary human services to our citizens. For those agencies or organizations that are primarily involved in arts, cultural, and related activities, I am recommending a 10% across-the-board reduction. The only exception is for the Virginia Living Museum because of this government's long-term commitment to sustain and enhance this facility, which is located on land it leases from the City.

Tax and Fee Adjustments

For the second consecutive budget year, there are no local tax rate adjustments recommended. Given the very difficult economic environment facing businesses and residents, tax rate increases were never considered in the development of the FY2010 Operating Budget. Likewise, in light of declining revenues overall and an $11.6 million gap that had to be closed, it was also not possible to reduce the real estate or personal property rates that generate almost 55% of General Fund revenues.

However, as the City has done consistently in the past, where the cost of providing solid waste services, sanitary sewer collection, stormwater management and the provision of drinking water to our regional customers has gone up, modest fee increases are being recommended. For example, the following user fee increases are being recommended: water consumption rate 5.3%; the stormwater management fee 6.8%, and the residential solid waste fee 7.0% (this rate adjustment is already provided for in the City Code). Though there is no increase in the standard sewer user fee, there is an urgent need to double the sewer user fee surcharge from $0.45 per hundred feet of water used, to $0.90 per hundred cubic feet, because of the escalating costs of meeting our State/Federal Consent Order obligations to identify and correct stormwater infiltration into our sanitary sewer collection system. This infiltration results in sewer overflows which degrade the water quality in receiving streams, the James River and the Chesapeake Bay. A more detailed explanation of the factors influencing this surcharge recommendation will be provided in one of the

Briefing Papers. Even though these user fees are being increased, the departments involved in managing these important utility programs have applied spending controls and staffing adjustments to minimize the expense which must be passed on to our customers and citizens.

Conclusion

As discussed in the beginning of this budget message, the preparation of the FY2010 Operating Budget has been an extremely difficult undertaking. With less revenue expected in FY2010 than budgeted for in FY2009, simply holding the line on expenditures and freezing salaries and wages was not sufficient to eliminate the emerging divergence between revenues and required spending needs. To balance our Budget for FY2009, we had to take into account budget salary savings when positions turn over due to terminations and retirements. This approach, however, would not generate nearly enough salary savings in the FY2010 Budget to keep it balanced. Therefore, I have had to recommend that a significant number of positions either be abolished or left unfunded for all of FY2010. Had the City not acted early in FY2009 to suspend most hiring and to reduce capital expenditures, the consequences of an $11.6 million revenue shortfall would have been much more significant. While I would hope the City sees in FY2011 some recovery of lost revenues, as the recession ends and local economic activity improves, the full impact of the slumping housing values will be felt in that fiscal year. Given the potential magnitude of the assessment decline, yet another year of limited resources and tough spending controls is likely. When looking ahead, it becomes quite apparent that the staffing and spending adjustments that were required for FY2010 will have to be sustained for longer than just one year.

As difficult as the development of my Recommended FY2010 Operating Budget has been, I firmly believe it represents a solid financial foundation for our City government, despite the challenging revenue situation we are facing. While the cuts being proposed will hurt, and there will be service impacts, the Recommended Operating Budget does not put the City at financial risk. Next year's budget will start, and end, in balance because of the conscientious efforts of my Executive and Management Teams. Together, we have formulated a realistic and responsible financial plan that recognizes and addresses the basic needs of our citizens. Also, this plan will not undo our concerted efforts over the past three fiscal years to properly finance our organizational infrastructure requirements. The Budget will provide our employees with the vehicles, equipment, IT resources, and training that are necessary for them to be efficient and effective in performing their respective duties. I do not need to tell you that this City government is blessed with a very talented and highly motivated work force which will perform well, despite having to cope with a salary freeze and benefit restructuring. Unlike private organizations that have less business or products to be sold during an economic downturn, our City government is faced with ever increasing demands as citizens look to us for help.

As City Council reviews this Budget Plan and debates service priorities and spending reductions, I ask only that you recognize this Budget document is the product of an extensive amount of collaboration and thoughtful analysis. There are certainly other viable alternatives to cut spending to a level that will match expected revenues. As we proceed with the review process, my staff and I pledge to work with City Council to be sure that the final outcome of your deliberations over the next few weeks is an adopted FY2010 Operating Budget, which is in the best interest of our community and our City government organization, and its almost 3,400 committed and caring employees.

Randy

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Attachments